



Public Service Commission of Wisconsin

Cheryl L. Parrino, Chairman
Daniel J. Eastman, Commissioner
Joseph P. Mettner, Commissioner

610 North Whitney Way
P.O. Box 7854
Madison, WI 53707-7854

May 2, 1997

The Honorable John D. Dingell
Commerce Committee Democratic Office
U.S. House of Representatives
Rayburn House Office Building, Room 2125
Washington, DC 20515-6115

Dear Representative Dingell:

Thank you for your interest in the Wisconsin Public Service Commission's (Commission) viewpoints on potential federal legislation that would implement retail competition for electricity service. Restructuring the electric industry is a key policy issue as this century draws to a close. How it is implemented will have important long lasting effects. Consequently, I appreciate being able to share with you our experience and insight.

In your April 10, 1997, letter there were 15 specific topic areas regarding electric utility restructuring to which you desire response. Attached to this letter you will find this Commission's responses to those inquiries. You will also find enclosed a copy of a recent report this Commission sent to the Wisconsin Legislature and Governor outlining a 32-step Workplan over the next several years which would at a minimum make the generation of electricity more competitive and potentially make retail electricity service open to competitive markets.

I hope the attached material is of assistance to you. Since both the questions and answers cover much ground, do not hesitate to have someone from your staff contact Robert Norcross, Electric Division Assistant Administrator, at (608) 267-9229, should you have any follow-up questions.

Sincerely,

Cheryl L. Parrino
Chairman

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Attachment

cc: Sue Sheridan, Minority Counsel, House Commerce Committee
Margaret Welsh, NARUC
Susan E. Stratton, Electric Division

Responses to Retail Competition Questions

- 1. Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?**

The Public Service Commission of Wisconsin has considered the issue of retail competition and has made no final decision as to whether or not it should be implemented in our state. The Commission has been analyzing this issue since 1995 as part of an investigation of future electric industry restructuring. In early 1996, the Commission issued a report to the Wisconsin Legislature outlining a 32-step Workplan over the next four years. That report is attached. The plan adopted by this Commission would, through time, deregulate new electricity generation and reregulate the natural monopoly transmission and distribution line functions. With respect to retail or direct access, the adopted plan would move the state's utilities in that direction; however, the Commission maintained various check phases to make sure the technology, implementation, and timing were such that all customers would benefit before any final go-ahead decision would be made on retail competition. If all prerequisites of retail competition are met as set forth in the Commission's Workplan, retail competition could be implemented in the state in the year 2001. The Commission intends to review the Workplan in late June 1997 to determine if changes to it are necessary based on current circumstances.

- 2. Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?**

The State of Wisconsin has not asked Congress to enact legislation mandating retail competition.

3. **Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?**

On the stranded cost issue, it is not clear whether the Public Service Commission of Wisconsin would or would not have sufficient authority to resolve any problems should Congress enact legislation providing for retail competition by a certain date. The reason is that Wisconsin is currently a state with low cost generation and low electricity rates. During the Commission's investigation, some participants felt it was more likely to be the case that there would be "stranded gains." That is, the generation assets in Wisconsin could very well have increased economic value as a result of deregulation, not decreased value. Congress could alleviate problems associated with stranded cost recovery by leaving significant flexibility with the states to address this issue.

4. **Are there other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978 (PURPA)?**

This Commission currently has necessary authority to protect consumers and to address issues which might arise if PUHCA were repealed. Section 196.795, Wis. Stats., provides the Commission with direct authority to oversee the operations of public utility holding companies in a manner which protects consumers captive to the regulated operations of those companies. The protections available under that statute have basic similarities to those currently available under PUHCA.

In contrast, if PURPA were repealed, there are areas where the Commission could lose some of its current ability and authority to foster competition in the electricity generation market. As a means of complying with PURPA, the Commission has adopted a competitive bidding process which certain new generation facilities must pass through prior to receiving construction certification. Since its inception, that process has resulted in the first two large-scale, independent power projects being developed in the state in lieu of projects being sponsored by regulated utilities, and therefore, has improved competition in the generation market. Unlike the situation in other states, these independent power projects are low cost. The Commission has no direct authority to require competitive bidding for new generation, so partial authority for that process has been drawn from the need for Wisconsin to comply with PURPA. If PURPA were repealed, Wisconsin's current generation competitive bidding process may be subject to legal challenge.

5. Would any constitutional issues be raised by federal legislation:

- a. mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?**
- b. requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?**

The Commission is not in a position to say whether there would be Constitutional objections to any federal action mandating retail competition. Any such objections would likely arise out of the details of the legislation. It is possible to say, however, that states jealously protect their current prerogatives. As such, federal legislation requiring states to conduct a formal proceeding

examining the merits of retail competition would be better received than legislation mandating states to adopt retail competition by a date certain or face a federal preemption imposing such a policy.

6. From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?

Not grandfathering in any prior state action on retail competition would not pose a problem in Wisconsin since the Commission has not adopted retail competition per se. Federal legislation mandating retail competition could impinge on the adopted restructuring process in Wisconsin. That process would further deregulate wholesale electricity markets before making any final determination on retail competition. Any such federal legislation mandating retail competition could affect the orderly process that has already commenced in this state. This would especially be the case if the federal legislation required retail competition any sooner than the year 2001. That is the earliest year such a policy would effectively be in place in Wisconsin if all steps in the Commission restructuring Workplan are implemented successfully and on time.

7. In hearings before the Energy and Power subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small residential and business customers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.

a. Are you aware of any study or analysis relevant to your state that supports such a conclusion?

All retail electric service in Wisconsin provided under the jurisdiction of the Commission is provided under tariffed rates. Special, negotiated contracts for retail electric service are not

allowed under state law. The Commission is not aware of any study or analysis that has been done which supports the conclusion that industrial customers have been able to negotiate lower electric rates in Wisconsin.

b. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether this trend has altered in recent years.

The Commission has not compiled historical information on the relationship between industrial and residential electric rates. The Commission does not believe that the rates it establishes for retail electric service result in subsidies of one class by another.

8. Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.

Although the Commission has not conducted a formal analysis of rate trends, depending upon the utility, retail electric rates have been stable or have declined slightly during the past ten years in Wisconsin. The Commission has not conducted any analyses regarding possible changes in the relative relationship between the various rate classes during this period. In general, however, these relative relationships have not changed appreciably.

9. Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these ideas? In a restructured electric industry, who should receive the benefits of these low-cost resources --utility ratepayers, utility shareholders or the highest bidder?

Retail competition would affect the current sharing of risk by utility shareholders and ratepayers. The effect would vary by individual state depending on the nature of the current regulatory process being used. In Wisconsin, there is a tradition of extensive planning and pre-approval for

the construction of generating units and transmission\distribution lines. In Wisconsin, the Commission also uses a biennial rate making process. The Commission has also followed a policy keeping regulated utilities financially strong. For instance, the major IOUs in Wisconsin have “AA” credit ratings. In this type of regulatory environment, shareholders are more likely to receive certainty that a pre-approved cost will be recovered. Therefore, any move towards increased competition in the generation and retail merchant areas would most likely mean that shareholder risk would increase for those respective functions. Ordinarily, increased risk requires increased compensation. In a low-cost state like Wisconsin, the overall effect on ratepayers depends on whether any financial cost increases associated with increased shareholder risk could be mitigated by any cost efficiencies that increased competition would foster in other areas like fuel procurement, the cost of new unit construction, or in operations and maintenance. Because the current regulatory process has produced low rates in Wisconsin, one of the mechanisms this Commission has tentatively approved in dealing with the shareholder and ratepayer risk issue is to tie existing low cost generation units to current ratepayers. At present, the details of such tying have not been worked out.

- 10. Of those states which have adopted retail competition, how many have addressed the issue of “reciprocity,” (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?**

Requiring reciprocity as a condition for retail competition would more likely benefit current electric utilities in a state than customers. This view is based on the fact that if retail competition is adopted, customers should be given the widest possible range of choice and opportunity.

Restricting that choice in any fashion would not be to the benefit of retail end users. On the other

hand, a lack of reciprocity would handicap potential Wisconsin sellers of electricity in other states' markets. In essence, reciprocity levels the playing field in terms of rules promoting interstate competition, but it is not absolutely necessary for an individual state's retail customers to benefit.

11. If Congress were to require “unbundling” of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?

As part of the plan restructuring Wisconsin's electric industry, utilities are required to file and to implement plans segmenting their vertically integrated operations into four business components: generation, transmission lines, distribution lines, and retail provision of service. This conceptual approach was deliberately taken in order to facilitate the unbundling of all utility functions of which local distribution company services is just one category. At a practical level, the problem is more likely to be separating out what true distribution and retail service functions are and maintaining high customer service standards. For instance, at the residential level the question of who owns the meter measuring service and related information could pose some difficulty. In addition, customer call center responsibilities must be properly designated to assure safety and service quality. While unbundling of local distribution company services is a necessary consideration for retail competition to be effective, requiring unbundling is a less difficult matter to attend to than how the full utility itself should be disaggregated.

12. Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?

There are no federal power marketing agencies in Wisconsin; therefore, there are no particular problems associated with federal public power. However, in Wisconsin there are other public power entities. These are significantly smaller than the IOUs which operate in the state. These

public power entities have expressed a deep concern during our restructuring processes that, due to their small size and the fact that many are geographically surrounded by transmission-owning IOUs, a more competitive market could actually threaten their current ability to get access to cheap wholesale power. In addition, these entities have also expressed the fear that their largest load customers could be “cherry picked” by non-public entities, leaving their remaining smaller customers to bear the brunt of any future increased costs. Such a situation would undermine their very existence as it is structured today. These utilities have also expressed a concern that either they would be prohibited from competing outside their territory based on IRS requirements associated with government loans or they would lose the low interest financing.

13. How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?

Without knowing a date or associated details, there is no clear answer regarding future funding for the Commission as a result of any federal legislation mandating retail competition. It is possible that the near term date for retail competition could be such that the Commission’s current resources would not be adequate to accomplish the necessary review and analysis. If that were the case, the Commission would have to seek additional funding from the state or do a less than adequate job in its role of implementing retail competition.

14. Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?

The Commission and the State of Wisconsin have not considered or adopted any securitization plan related to utility stranded assets.

15. There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.

a. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can “effective competition” be achieved regardless of whether Congress enacts changes to PUHCA?

Given the record level of merger activity being experienced in the industry, it could be argued that the interconnection requirements of PUHCA, as historically administered by the Securities and Exchange Commission (SEC), serve to impede the development of effective competition in regional markets, particularly at the retail level. The basis for such arguments would be that the interconnection requirements are influencing the merger marketplace such that utilities tend to choose merger partners with adjacent or nearby service territories. Such merger activity can have a tendency to create high concentrations of supply ownership and market share within regions, which may undermine the effectiveness of competition both at the wholesale and retail levels. It may be that as wholesale and retail electricity markets continue to develop, mergers between geographically remote utilities would be preferable from a policy standpoint, so that each regional marketplace has available to it a sufficient number of competitors.

b. Do you believe Congress should modify or repeal PUHCA? If so, why, and under what conditions?

It would be appropriate to consider repeal or modification of PUHCA within the context of overall restructuring of the electric industry. Targeted reform initiatives outside of that context might focus on the competitive issues associated with the PUHCA interconnection requirements, as discussed above, and also might provide recognition of the roles the SEC’s securities regulation and disclosure requirements already play in providing some of the structural

protections envisioned under PUHCA. Targeted reform could also concentrate on amendment of the affiliated transaction pricing rules currently administered by the SEC, as discussed more fully below. Finally, any outright repeal of PUHCA should transfer necessary authorities to the states and to the Federal Energy Regulatory Commission to ensure that access to books and records is adequate to oversee the regulated operations of registered holding companies.

c. Should Congress enact legislation to modify the holding in Ohio Power Co. v. FERC, 954 F.2d 779 (D.C. Cir. 1992)?

Yes, the regulatory gap created by the Ohio Power decision should be closed by Congress. A good deal of attention in recent merger cases in Wisconsin, where the merging partners will acquire registered holding company status and conduct business utilizing Service Company arrangements, has focused upon ways to mitigate risk of preemption of state rate setting authority due to the Ohio Power decision. With the combination of its ability to influence the resource decisions made by Wisconsin utilities, its auditing authority and resources, and its authority to regulate holding companies and affiliated contracts and arrangements between associate companies, the Commission has adequate ability to protect consumers and competitors from cross-subsidization. However, that ability would be undermined if Commission transfer pricing, rate setting, and cost recovery decisions are held to be preempted by SEC determinations due to Ohio Power.